(2)

Supreme Court, U.S.
FILED
AUG 1 1994
OFFICE OF THE CLERK

No. 93-1707

In the Supreme Court of the United States

OCTOBER TERM, 1994

PAUL G. SCHMIDT, ET AL., PETITIONERS

v.

MIKE ESPY, SECRETARY OF THE
UNITED STATES DEPARTMENT OF AGRICULTURE

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

DREW S. DAYS, III
Solicitor General
FRANK W. HUNGER
Assistant Attorney General
MICHAEL JAY SINGER
JENNIFER HAY ZACKS
Attorneys
Department of Justice
Washington, D.C. 20530
(202) 514-2217

QUESTION PRESENTED

Whether petitioners' application for relief under a leaseback/buyback program administered by the Farmers Home Administration was properly denied on the ground that petitioners had acted in bad faith.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Discussion	7
Conclusion	11

Statutes and regulations:

Food, Agriculture, Conservation, and Trade Act of 1990, Pub. L. No. 101-624, 104 Stat. 3359:	
§ 1816(e), 104 Stat. 3827	3
§ 1861(a), 104 Stat. 3837	3
§ 1861(c), 104 Stat. 3838	3
7 U.S.C. 2000(c)(1)(B)	6
7 U.S.C. 2000(c)(1)(C)	6
7 U.S.C. 2001(b)(2)	2
7 C.F.R.:	
Section 1951.902(b)(4)	2
Section 1951.902(b)(5)	2
Section 1951.906	2
Section 1951.909(c)(2)	2
Section 1951.911(a)(4)	3
Section 1951.911(a)(4)(i)	8
Section 1951.911(a)(4)(i)(1)	7
Section 1951.911(a)(4)(i)(A)	9
Section 1951.911(a)(4)(i)(A), Note	9
Section 1951.911(a)(4)(i)(2)	7

In the Supreme Court of the United States

OCTOBER TERM, 1994

No. 93-1707

PAUL G. SCHMIDT, ET AL., PETITIONERS

v.

MIKE ESPY, SECRETARY OF THE
UNITED STATES DEPARTMENT OF AGRICULTURE

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The decision of the court of appeals (Pet. App. A4-A8) is reported at 9 F.3d 1352. The orders of the district court (Pet. App. A8-A40) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on November 19, 1993. Pet. App. A4. A petition for rehearing was denied on December 28, 1993. *Id.* at A2. On February 22, 1994, Justice Blackmun extended the time within which to file a petition for a writ of certiorari to and including April 27, 1994. *Id.* at A1. The petition for a writ of certiorari was filed on April 26,

1994. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Farmers Home Administration (FmHA) administers a federal loan program intended to provide farmers with low-interest mortgages. Participants who fall behind in their mortgage payments may be eligible for primary or preservation loan servicing. Primary servicing is available only to borrowers who retain an ownership interest in the mortgaged property. Options under that program include rescheduling and reamortization of loans, and write-down of debts. See 7 C.F.R. 1951.906. Eligibility for primary loan servicing requires that the borrower have acted in good faith. 7 C.F.R. 1951.909(c)(2); see 7 U.S.C. 2001(b)(2).

Preservation loan servicing—including the leaseback/buyback program at issue in this case—may be available at two separate stages of the servicing process. First, pre-acquisition preservation servicing is considered at the conclusion of primary servicing, but prior to acceleration and forced liquidation. In that situation, a borrower voluntarily deeds the property to the FmHA, in exchange for an option to lease or buy the land back. See 7 C.F.R. 1951.902(b)(4). Post-acquisition preservation servicing is considered after a foreclosure, and only if the FmHA acquires the property. If the property passes into FmHA inventory, the borrower may again apply to lease the property from the United States, with an option to buy it back. See 7 C.F.R. 1951.902(b)(5).

The 1990 Farm Bill amended the leaseback/buyback provision, imposing a requirement (parallel to that already in effect for primary loan servicing under 7 U.S.C. 2001(b)(2)) that applicants have acted in good faith in their dealings with the Department of Agriculture.

See Food, Agriculture, Conservation, and Trade Act of 1990, Pub. L. No. 101-624, § 1816(e), 104 Stat. 3827. Those amendments were effective upon the date of enactment, November 28, 1990. See § 1861(a) and (c), 104 Stat. 3837-3838. Pursuant to the 1990 law, the Secretary has promulgated regulations providing, in pertinent part:

> (i) Any applicant for leaseback/buyback who either (1) first applied for primary servicing on or after November 28, 1990, or (2) first applied for leaseback/buyback on or after November 28, 1990, without first applying for primary servicing * * * must have acted in good faith * * *.
>
> (A) If a good faith determination has already been made in connection with the borrower/former borrower's request for primary servicing of his or her loan * * *, such determination will be binding on the * * * request for leaseback/buyback * * *. NOTE: If the lack of good faith determination was made prior to November 28, 1990, for primary servicing, which was based on the sole fact that the borrower disposed of normal income security before October 14, 1988, without FmHA consent, and it has been determined the proceeds were used for essential household and farm operating expenses of which the borrower would have been entitled to a release of income proceeds in accordance with [the relevant regulations], such a lack of good faith determination will not be binding for a leaseback/buyback application filed on or after November 28, 1990.

7 C.F.R. 1951.911(a)(4).

2. Petitioners are cattle farmers and egg producers in Washington County, Arkansas, who have participated in the FmHA loan program. Paul A. and Pauline B.

Schmidt are 50 percent shareholders of Acro Corporation, a family-owned business. Their son Paul G. Schmidt owns the balance of the corporation's shares. Petitioners owned three tracts of land on which the FmHA had liens. Tract I, which is at issue in this appeal, consisted of approximately 363 acres, subject to the prior lien of the Federal Land Bank of St. Louis. See Gov't C.A. Br. 11-12.

In February 1989, the FmHA notified petitioners of its intent to accelerate their loan. The notice explained that petitioners were $334,724.86 behind on their loan payments, that they had disposed of collateral without written approval from the FmHA, and that they had failed to provide the FmHA with required monthly cash-flow statements. See C.A. App. 114-119. In March 1989, in response to the FmHA's notice of intent to accelerate the loan, petitioners requested, *inter alia*, that they be considered for all primary and preservation loan programs. *Id.* at 120. Petitioners submitted various supporting documents the following month. See *id.* at 81 ¶ 21.

On April 12, 1989, the Farm Credit Bank (which succeeded the Federal Land Bank as lienholder) instituted judicial proceedings to foreclose its mortgage on Tract I. C.A. App. 82 ¶ 23. Judgment was entered on February 20, 1990, and on April 10, 1990, the FmHA acquired the property at a judicial sale. *Id.* at 82 ¶ 25. Due to their loss of ownership of the property, petitioners were no longer eligible for primary loan servicing on Tract I. However, petitioners continued to pursue an administrative appeal concerning the FmHA's announced intention to accelerate their loans and their still-pending request for primary loan servicing for Tract II. On June 8, 1990, the Hearing Officer upheld the FmHA's prior finding that petitioners had failed

properly to account for collateral, noting that "there is some evidence to conclude that there was lack of good faith because of waste." Pet. App. A62. The Hearing Officer further stated that the "FmHA's determination of acting in bad faith for failing to provide monthly cash flow statements as agreed and requested is upheld." *Id.* at A63.

By letters dated July 6, 1990, the FmHA notified petitioners of the possible availability of preservation loan servicing, including leaseback/buyback, with respect to Tract I. See C.A. App. 160, 198-199. By letter dated December 28, 1990, petitioners notified the agency that they wished to be considered for leaseback/buyback. *Id.* at 200. On December 3, 1991, the County Supervisor denied petitioners' application, stating that petitioners had failed to supply essential information in support of their request and that the prior bad faith determination was binding on petitioners' request for leaseback/buyback. Pet. App. A51. On March 5, 1992, the Hearing Officer upheld the denial, citing the same two grounds. *Id.* at A45-A50. That decision in turn was affirmed by the State Director. *Id.* at A44-A45. The National Appeals Staff subsequently determined that "the decision by the County Supervisor to deny leaseback/buyback because of lack of good faith should be upheld." *Id.* at A41. The National Appeals Staff noted that "[b]ecause we are upholding the lack of good faith determination, the failure to furnish monthly financial statements and the failure to provide updated financial information are moot issues." *Id.* at A43.

3. The district court sustained the FmHA's decision, concluding that the denial of leaseback/buyback was "not arbitrary, capricious or illegal" and was supported by substantial evidence in the record. Pet. App. A23. The court of appeals affirmed in relevant part, likewise sus-

taining the Secretary's denial of petitioners' application for leaseback/buyback. *Id.* at A5.[1] The court of appeals explained:

> On appeal, the [petitioners] do not dispute the county supervisor's holding that they acted in bad faith and thus are ineligible for primary loan servicing. The [petitioners] contend, however, that the Secretary failed to follow his own regulation when he denied leaseback/buyback based on their bad faith. The [petitioners] assert the county supervisor's earlier bad faith finding on their request for primary loan servicing is not applicable to their request for leaseback/buyback because 7 C.F.R. §1951.911(a)(4)(i) (1993) makes clear that good faith is required only for leaseback/buyback applications made after November 28, 1990. According to the Secretary, the [petitioners'] reliance on the regulation is misplaced. The Secretary contends subpart (A) of the regulation bars the [petitioners'] request. *See id.* §1951.911(a)(4)(i)(A) (earlier bad faith determination made in connection with primary servicing binds request for leaseback/buyback). With both parties relying on different provisions of the same regulation, we cannot say the Secretary's interpretation of the regulation "is without a rational basis."

---

[1] Petitioners also challenged the denial of their application for homestead protection under 7 U.S.C. 2000(c)(1)(B) and (C). The court of appeals reversed the agency's determination, concluding that petitioners were entitled to have their eligibility for the homestead exemption measured by a method different from the one used by the Secretary. See Pet. App. A6-A8. The court therefore remanded that aspect of the case to the Secretary for further consideration. *Id.* at A8. The Secretary has not sought further review of that ruling.

Pet. App. A5-A6.

DISCUSSION

Petitioners contend (Pet. 15-23) that the court of appeals has erroneously interpreted 7 C.F.R. 1951.911(a)(4)(i)(1) and (2) to impose a good faith requirement with respect to leaseback/buyback applications filed before November 28, 1990. We do not believe that petitioners' claim warrants this Court's plenary review. After further examination of the regulation and its application in the present case, however, the Department of Agriculture has determined that petitioners' leaseback/buyback application should be reconsidered without respect to the good faith requirement.

1. The government does not believe, and has never contended in this case, that the good faith requirement applies to leaseback/buyback applications filed before November 28, 1990. Rather, the government's position has been that the pertinent application in this case was filed after that date. Petitioners' loss of their ownership interest in Tract I (due to the bank's foreclosure) negated the possibility that they could receive primary loan servicing on that property. As to Tract I, the foreclosure thus effectively extinguished petitioners' application for primary servicing filed in March-April 1989. Petitioners did not request post-acquisition leaseback/buyback until December 28, 1990—after the November 28, 1990, effective date of the 1990 Farm Bill. See C.A. App. 200.

2. The various administrative decision-makers all assumed, without substantial explanation, that because petitioners' leaseback/buyback application was filed after November 28, 1990, it was subject to the good faith requirement. The operative provision of the regulation,

however, does not so state, and the regulation as a whole is internally inconsistent on the point.

The regulation does not state that all leaseback/buyback applications filed on or after November 28, 1990, are subject to the good faith requirement. Rather, it provides that "[a]ny applicant for leaseback/buyback who either (1) first applied for primary servicing on or after November 28, 1990, or (2) first applied for leaseback/buyback on or after November 28, 1990, without first applying for primary servicing, * * * must have acted in good faith." 7 C.F.R. 1951.911(a)(4)(i). Petitioners, who did first apply for primary servicing and did so in March-April 1989, do not fall into either category. Read in isolation, the quoted language implies that persons who first applied for primary servicing before November 28, 1990, are not subject to the good faith requirement with respect to a leaseback/buyback application filed on or after that date.[2]

---

[2] That language might plausibly be read as a "grandfather" provision imposing a good faith requirement on leaseback/buyback applications only with respect to those applicants who entered the combined primary/preservation loan servicing process for the first time on or after November 28, 1990. Petitioners entered that process before November 28, 1990, by virtue of the application for primary and pre-acquisition preservation servicing they filed in March-April 1989. As explained above (see page 7, *supra*), the foreclosure sale of Tract I in April 1990 negated any possibility that that application could be granted. The lapse of that application could have been regarded as a termination of the combined primary/preservation loan servicing process prior to November 28, 1990. Imposition of the good faith requirement in this case might then have been justified on the ground that petitioners' December 28, 1990, request for leaseback/buyback was an entirely new application, subject to the new statutory good faith requirement. That rationale, however, was not set forth in the regulation or the administrative decisions below.

On the other hand, the Note following Section 1951.911(a)(4)(i)(A) suggests a contrary result. The Note states that a specified category of "good faith determination[s] [ ] made prior to November 28, 1990, for primary servicing * * * will not be binding for a leaseback/buyback application filed on or after November 28, 1990." See page 3, *supra*. That provision implies that *other* good faith determinations made prior to November 28, 1990, *will* be binding on subsequent leaseback/buyback applications, which suggests in turn that the good faith requirement for post-November 28, 1990, leaseback/buyback requests extends to at least some applicants who applied for primary servicing (and therefore entered the combined primary/preservation loan servicing process) before that date.[3]

3. The governing statute affords the agency considerable discretion to determine what categories (if any) of pre-November 28, 1990, applications for primary servicing should render the good faith requirement inapplicable to post-November 28, 1990, leaseback/buyback applications. The agency does not appear, however, to have articulated a clear policy on that point. The governing regulation does not yield a clear answer, and none of the administrative decision-makers in this case addressed that question in applying the regulation.[4] In

---

[3] Section 1951.911(a)(4)(i)(A) of the regulation, on which the court of appeals relied (see Pet. App. A[illegible], states that a bad faith determination made in ruling on a prior application for primary servicing will be binding on a subsequent application for leaseback/buyback. That provision does not make clear, however, whether post-November 28, 1990, leaseback/buyback applicants who first requested primary servicing prior to that date are subject to the good faith requirement in the first place.

[4] The government's brief in the court of appeals made clear that the agency believed that the effective date of petitioners'

light of the inconsistency between different parts of the governing regulation, and the absence of explanatory materials, the Department of Agriculture has determined that petitioners' post-acquisition leaseback/buyback application should be reconsidered without regard to the good faith requirement.[5] Although the court of appeals' decision does not warrant plenary review, it would be appropriate for this Court to vacate the judgment below and remand the case to the court of appeals, which in turn should remand the case to the Secretary for further consideration of petitioners' application.

---

leaseback/buyback application was December 28, 1990, rather than March-April 1989. See Gov't C.A. Br. 37-38. The brief did not, however, discuss the question whether a pre-November 28, 1990, application for primary servicing could affect the applicability of the good faith requirement to a post-November 28, 1990, leaseback/buyback request. The brief also suggested that the March-April 1989 application for primary servicing might have pertained only to Tract II, on which FmHA held a first mortgage, and not to Tract I, the land at issue in this case. See *id.* at 38. Further review of the record persuades us that that position is factually incorrect.

[5] Administrative decision-makers at two levels denied petitioners' leaseback/buyback application both on the basis of bad faith and on the alternative ground that petitioners had failed to supply essential information. See Pet. App. A51, A44-A45. The National Appeals Staff did not rule on the validity of the latter basis for denial, concluding that "[b]ecause we are upholding the lack of good faith determination, the failure to furnish monthly financial statements and the failure to provide updated financial information are moot issues." *Id.* at A43. It is therefore possible that the agency, upon reconsideration of petitioners' application, will ultimately determine that the application should be denied based on the failure to provide required information.

CONCLUSION

The petition for a writ of certiorari should be granted, the judgment of the court of appeals should be vacated, and the case should be remanded to the court of appeals for further proceedings in light of the position stated in this brief.

Respectfully submitted.

DREW S. DAYS, III
Solicitor General

FRANK W. HUNGER
Assistant Attorney General

MICHAEL JAY SINGER
JENNIFER HAY ZACKS
Attorneys

AUGUST 1994